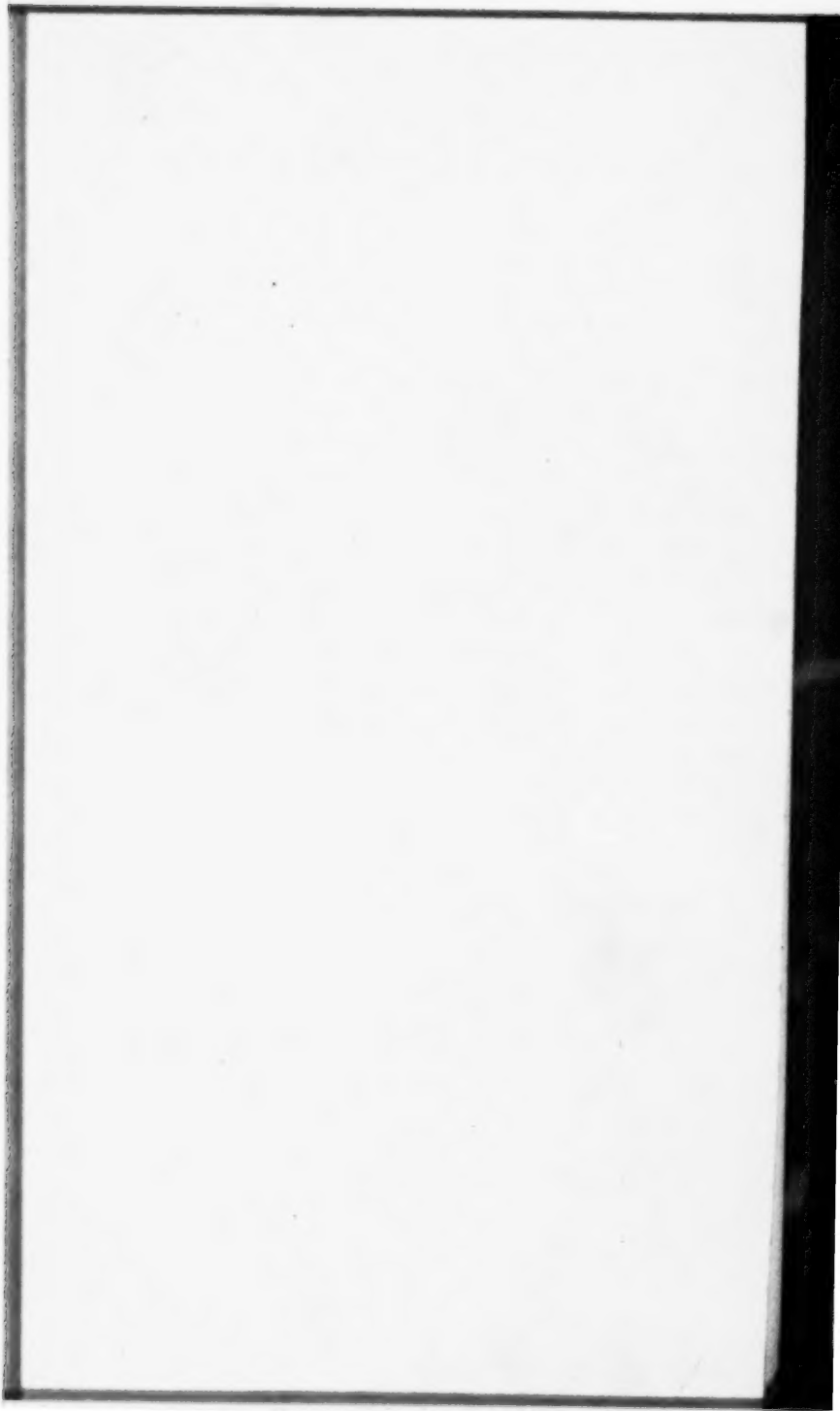

FILE COPY

Office Supreme Court, U.
FILED
DEC 21 1929
CHARLES ELMORE CROP
CLERK

Supreme Court of the United States

OCTOBER TERM, 1929

NO. 114

FREDERICK C. RENZIEHAUSEN, Petitioner,

v.

ROBERT H. LUCAS, as Commissioner of Internal Revenue.

BRIEF FOR PETITIONER.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

747 Union Trust Building,
Pittsburgh, Pa.

EDWIN W. SMITH,
WILLIAM A. SEIFERT,
WILLIAM WALLACE BOOTH,
Attorneys for Petitioner.

SMITH BROS. CO. INC., LAW PRINTERS, 208-212 GRANT STREET, PITTSBURGH, PA.

INDEX.

	PAGE
Opinions Below	1
Jurisdiction	1
Statement of the Case	2
Specification of Errors	8
Summary of Argument	9

Argument:

I. Intangible Assets Consisting of Trade Marks, Trade Brands, Trade Names and Good Will of a Distillery and of a Wholesale Liquor Business are Subject to Obsolescence During the Years 1918, 1919, 1920 and 1921 Under the Applicable Revenue Acts as a Result of Federal Legislation Which Proscribed Such Business 11

A. The Nature of the Deduction 11

B. Good Will is Property Within the Purview of Section 214 (a) (8) of the Revenue Act of 1918 14

C. Good Will is Property Which is Subject to Exhaustion and to Obsolescence. The Deduction is not Limited to Assets Which are Subject to Wear and Tear by Use in the Business 15

D. The Word "Including" is a Word of Enlargement, having the Same Meaning as "Also" and as the Conjunction "And".. 24

E. The Construction of the Revenue Act of 1918 by the Treasury Department Confirms the Intention of Congress to Grant a Deduction on Account of Obsolescence of Intangibles, and such Construction Has the Force and Effect of Law 28

PAGE

F. As to the Spread of Obsolescence..... 32

II. The Depreciated Value of the Plant and Equipment of a Distillery is Subject to Obsolescence Spread Over the Period From 1918 to 1921, Inclusive, as a Result of Federal Legislation Which Proscribed Such Business 34

III. Profits Derived From the Sale of "Old Whiskey" Should be Taxed at the Capital Gain Rate 36

A. The "Old Whiskey" Was a Personal Investment of the Petitioner, Held by Him for More than Two Years, and Was Not Properly Part of His Stock in Trade... 36

B. All Stock in Trade or Inventory Became a Capital Asset Immediately Upon the Cessation of the Usual Course of Business and the Beginning of Involuntary Liquidation 38

IV. If Intangible Assets Are Not Subject to Obsolescence, a Deduction On Account of the Loss of Said Intangibles Based On Cost As a Result of Prohibiting Federal Legislation Should Be Allowed..... 42

V. Principles of Construction Applicable..... 44

Conclusion 45

Appendix:

Revenue Act of 1917, Section 207 (a)..... 47

Revenue Act of 1918, " 214 (a) (4) (8). 47

" 325 (a)..... 48

" 326 (a) (4) (5). 48

Revenue Act of 1921, " 206 (a) (b)..... 48

" 214 (a) (8).... 49

" 325 (a)..... 49

" 326 (a) (4) (5). 49

PAGE

Willis-Campbell Act..... 49 50
Bulletin "F".....51-55
T. D. 2929..... 55
T. B. R. 44.....56-64
O. D. 298..... 64
O. D. 344..... 64

CITATIONS.

American Valve Company, Appeal of 4 B. T. A. 1204 35
Camden v. Stuart, 144 U. S. 104..... 15
Clarke v. The Haberle Crystal Springs Brewing Co., No. 68 October Term, 1929..... 43
Coca Cola Bottling Co. v. Coca Cola Co., 269 Fed. 796 15
Copper Queen v. Arizona Board, 206 U. S. 474, 479. 32
Edwards v. Darby, 12 Wheat. 206..... 31
Gould v. Gould, 245 U. S. 151, 153..... 44
Haberle Crystal Springs Brewing Co. v. Clarke, 30 Fed. (2d) 219..... 23
Henrici Co. v. Reinecke, 3 Fed. (2d) 34..... 16
Hiller v. United States, 106 Fed. 73..... 26
Jack's v. Commissioner, 18 B. T. A. ——..... 43
Kaufmann & Strauss Co. v. Lucas, 12 Fed. (2d) 774 16
Kentucky Tobacco Products Co. v. Lucas, 5 Fed. (2d) 723 .....16, 19
Lassen Lumber & Box Co. v. Blair, 27 Fed. (2d) 17 16
Lynch v. Alworth-Stephens Company, 267 U. S. 364 .....14, 16, 44
Manhattan Brewing Co., Appeal of 6 B. T. A. 952 .....14, 16, 23, 35
Metropolitan Bank v. St. Louis Dispatch Co., 149 U. S. 436..... 15
Monongahela Navigation Co. v. United States, 148 U. S. 312..... 18

PAGE

New Haven Railroad v. Commerce Commission, 200 U. S. 361, 401 32
Old Colony Trust Company et al., Executors, v. Commissioner, 279 U. S. 716 2
Red Wing Malting Co. v. Willcuts, 15 Fed. (2d) 626 .....13, 31
Robertson v. Downing, 127 U. S. 607, 613 31
Sawilowsky v. Brown, 288 Fed. 533 15
Sullivan Machinery Co. v. United States, 168 Fed. 561 26
United States v. Boston & Maine R. R., 279 U. S. 732 32
United States v. Isham, 17 Wall 496, 504 44
United States v. Merriam, 263 U. S. 179 44
United States v. Pierce, 147 Fed. 199 26
United States v. Wigglesworth, 2 Story 368, 374 44
Van Kannel Revolving Door v. Commissioner, 11 B. T. A. 1209 16
Washburn v. National Wall Paper Co., 81 Fed. 17 .15, 17

STATUTES:

Revenue Act of 1909 .....24, 25
" " " 1913 .....19, 24, 25
" " " 1916 .....19, 24, 25
" " " 1917, Section 207 (a) 17
" " " 1918, Section 214 (a) (1) 25
" " " " " 214 (a) (4) 7, 42
" " " " " 214 (a) (8) 9, 11, 28, 44, 45
" " " " " 234 (a) (1) 25
" " " " " 325 (a) 17
" " " " " 326 (a) (4) (5) 17
" " " 1921, " 206 .....7, 36, 39, 41, 44
" " " " " 325 (a) 17
" " " " " 326 (a) (4) (5) 17
" " " 1926, " 1003 (a) 1

PAGE

Tariff Act of July 24, 1897.....25, 26
Willis-Campbell Act.....22, 23, 34, 35, 38
Section 240 (a) Judicial Code..... 1
Eighteenth Amendment.....6, 22, 23, 32, 35, 38, 43

REGULATIONS & BUREAU RULINGS:

Regulations 33, Article 147 26
" " " 159 26
" 45, " 161 .....26, 27, 30
" " " 163 .....16, 30, 31
" " " 167 16
" 62, " 163 16
" " " 167 16
" 65, " 163 16
" " " 167 16
" 69, " 163 16
" " " 167 16
" 74, " 203 16
" " " 206 27
" " " 207 16
I. T. 2297..... 38
I. T. 2502..... 38
L. O. 862..... 28
T. B. R. 44.....28, 31, 32
O. D. 298..... 29
O. D. 472..... 29
O. D. 818..... 29
Bulletin "F" 29
T. D. 2929.....28, 31
T. D. 3760..... 17
T. D. 3980..... 31

ENCYCLOPEDIAS & DICTIONARIES:

28 Corpus Juris 730..... 15
Century Dictionary 16
Webster's New International Dictionary..... 15

Supreme Court of the United States

OCTOBER TERM, 1929

NO. 114

FREDERICK C. RENZIEHAUSEN, Petitioner,

v.

ROBERT H. LUCAS, as Commissioner of Internal Revenue.

BRIEF FOR PETITIONER.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 28) is reported at 8 B. T. A. 87. The opinion of the Circuit Court of Appeals for the Third Circuit (R. 113) is reported in 31 F. (2d) 675.

Jurisdiction.

The Judgment of the Circuit Court of Appeals was entered on March 7, 1929 (R. 118, 119). The petition for writ of certiorari was filed on May 27, 1929 (R. 121), and the writ was granted October 14, 1929 (R. 120).

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, c. 229, section 1, 43 Stat. 938, and under Section 1003 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 10.

Old Colony Trust Company et al., Executors, v. Commissioner of Internal Revenue, 279 U. S. 716, sustains the jurisdiction of this Court.

Statement of the Case.

Petitioner is a resident of Pittsburgh, Pennsylvania, and during the years in question was the sole owner of The Large Distilling Company and a partner in the firm of Schuetz, Renziehausen & Company (R. 31).

In 1796 Jonathan Large founded a whiskey distilling business, under the trade name of the Large Distilling Company, at Mount Washington (now a part of Pittsburgh), Pennsylvania. Three years later the distillery was moved to Jefferson Township, Allegheny County, Pennsylvania, where the business has been carried on since that time. From 1884 to 1897 the business was conducted as a partnership, composed of Henry Large and his wife, and the petitioner, Renziehausen. In 1897 Renziehausen became sole owner of the business, and thereafter to the present time conducted it as a sole proprietorship (R. 31).

The Large Distilling Company distilled rye whiskey under contract with wholesale liquor dealers. It also carried on a warehousing business. After the whiskey was distilled under contract, it was stored in bonded warehouses and there remained until withdrawn by the owners who held warehouse receipts for it and paid monthly storage charges therefor (R. 31).

"Large" whiskey, by which name the product of the Large Distilling Company was generally known, was distributed by wholesale and retail liquor dealers throughout the whole of the United States. It was generally regarded by the wholesale trade as one of the leading rye whiskeys of the country. For a long period

prior to 1913 and thereafter until the Large Distilling Company ceased distilling for beverage purposes in 1917, there was a steady growth in the demand for "Large" whiskey. The company seldom operated its distillery to full capacity. It was the practice to determine upon the quantity of whiskey to be distilled in the following season before soliciting contracts from the wholesale trade, and contracts were accepted with due regard to the total quantity to be distilled. Usually the quantity specified in the contract of a particular wholesale dealer was based upon the quantity upon which that dealer was making tax payments. The purpose of this was to prevent as far as practicable, speculation in warehouse receipts for "Large" whiskey. Because of these business practices, the demand for "Large" whiskey, as a general rule, exceeded the supply (R. 33).

From 1899 to 1913, inclusive, the Large Distilling Company expended for advertising the total sum of $82,500.02; and from 1914 to 1921, inclusive, it expended for the same purpose the total sum of $86,155.61. The advertising consisted of installing exhibits at local and international expositions, well-designed show cards, and displays in leading trade journals, newspapers, theatre programs, whiskey blotters, and the distribution of price lists. It exhibited its product at ten international expositions, viz: Chicago, 1893; Paris, 1900; St. Louis, 1904; Liege, 1905; Milan, 1906; Jamestown, 1907; Brussels, 1910; Ghent, 1913; London, 1914; and San Francisco, 1915; at nine of which it was awarded the grand prizes (R. 33).

In addition to the amounts expended specifically for advertising, the Large Distilling Company, between 1899 and 1913, inclusive, paid to its customers the total sum of $55,781.10 for leakage; and from 1914 to 1921, inclusive, the sum of $13,300.14. Leakage refers to the

evaporation while the whiskey is stored in the Government bonded warehouses in excess of the Government allowance, and upon which the owners of the whiskey were required to pay the tax. The tax on excess evaporation was paid by the owners and they were reimbursed by the Large Distilling Company, although there was no specific provision in the contracts under which the company could be held liable (R. 33, 34).

On July 19, 1897, the Large Distilling Company purchased a trade-mark for $5,000 cash (R. 34).

At March 1, 1913, the Large Distilling Company owned trade marks, trade names and trade brands as follows: Five-pointed star within a star; the label "Large Whiskey"; the slogan "Drink a Little Large"; and the company also had registered the label "Large, Established 1796, Monongahela Pure Rye Whiskey"; and "Pure Monongahela Rye Whiskey Made by Henry Large, Jr., Pittsburgh, Pennsylvania" within a circle (R. 34).

From the time he became a partner in the Large Distilling Company in 1884 to and including 1912 the petitioner Renziehausen was not paid any salary for his personal services. A reasonable compensation for the period 1908 to 1912, inclusive, for the services he rendered to the business would have been $15,000 per annum (R. 35).

The firm of Schuetz, Renziehausen & Company was engaged in the wholesale liquor business in Pittsburgh, selling brandies, cordials, fine liquors, and wines. At March 1, 1913, and thereafter until January 16, 1920, the effective date of the Eighteenth Amendment, the firm enjoyed the patronage of the most substantial retailers in the territory in which it did business (R. 38).

At March 1, 1913, Schuetz, Renziehausen & Company owned registered trade-marks for "Fort Pitt

Whiskey", "Diamond Monogram Whiskey", and "Crusador Dry Gin" (R. 38).

Liquidation of the business of Schuetz, Renziehausen & Company was begun in 1920 and completed in 1925. When prohibition legislation became effective its stock of merchandise consisted of brandies, cordials, gins, other fine liquors, and wines. The wholesale and retail drug trade would not buy this class of merchandise. A permit was obtained from the Commissioner of Internal Revenue to donate the stock to hospitals in accordance with their authorized quota, but this method of liquidation took too long and in 1925 all of the remaining stock was dumped in the sewers of the building, under Government supervision (R. 38).

The last whiskey produced by the Large Distilling Company for beverage purposes was distilled in May, 1917. Thereafter and until January 16, 1920, the effective date of the Eighteenth Amendment, no whiskey could be produced for beverage purposes because of war-time prohibition. With the imposition of war-time prohibition and the progress which had been made toward adoption of the Eighteenth Amendment, petitioner became convinced in 1918 that the distilling part of the business of the Large Distilling Company was through for all time, and that the business as a whole would be entirely wound up and liquidated within four years. During 1919 petitioner became aware that he could lawfully manufacture whiskey for medicinal purposes; and in the fall of that year the Large Distilling Company resumed distilling operations for the production of whiskey for medicinal purposes and continued such operations until at or about November 23, 1921, when, because of the enactment of the so-called Willis-Campbell Act, which provided that whiskey could be manufactured for medicinal purposes only under permits issued by the Commissioner of Internal Revenue,

and petitioner having failed to secure such a permit, distilling operations ceased (R. 35).

Petitioner claimed a March 1, 1913, value of $1,000,000.00 for the trade marks, trade brands, trade names and good will of The Large Distilling Company (R. 10, 23 (19)) and a March 1, 1913, value of $115,500.00 for the similar assets of Schuetz, Renziehausen & Company (R. 23 (23)). The respondent admitted the values in his brief filed with the Circuit Court of Appeals and the Circuit Court found there was no dispute as to the value of the intangible properties nor to the amount of the deduction, if any, to which petitioner is entitled (R. 114).

The depreciated value of the physical properties of The Large Distilling Company on January 1, 1918, was $276,652.79. The salvage value was $19,375.00 (R. 36, 37).

NOTE: There is a transposition in the findings of the Board. The total cost on January 1, 1918, should be $392,681.24 instead of $329,681.24. A correction for such error would give petitioner a larger deduction than he claims due to an undisclosed error in the itemized figures. Petitioner, however, only claims the deduction on the correct figures shown above.

The Eighteenth Amendment to the Constitution of the United States was proposed to the several legislatures of the States for ratification by Joint Resolution of Congress, which Resolution was deposited in the Department of State on December 19, 1917 (40 Stat. Pt. 1, p. 1050). It was ratified January 16, 1919, and became effective January 16, 1920.

Petitioner in 1908 commenced to invest his excess funds in whiskey, distilled by The Large Distilling Company, which he carried as an investment until maturity. This was a personal investment of the petitioner's but for the purpose of convenience it was carried on the books of The Large Distilling Company in an account captioned "Old Whiskey", petitioner having for a long period of time carried personal invest-

ments on those books (R. 39). Part of the whiskey was sold in 1922 after being carried as an investment by the petitioner for a period of more than two years (R. 39).

The Large Distilling Company is and has been since 1921 in the process of liquidation (R. 37) under certain restrictions and limitations imposed by various Federal and State prohibition laws (R. 37).

Petitioner claimed (a) deductions from gross income for income tax purposes on account of obsolescence of intangible property of both his distillery and wholesale liquor businesses (R. 4, 5, 27, 30), which businesses were proscribed by Federal legislation; (b) deductions on account of obsolescence of tangible property, plant and equipment, and in the alternative, deductions for depreciation sustained and a deduction for loss of useful value of tangible properties in 1921; (c) that Section 206 of the Revenue Act of 1921 (R. 5, 30), providing for the computation of tax on capital gain, was applicable to the disposal of whiskey after the advent of National Prohibition on two theories; first that the whiskey had been held by him as a personal investment for more than two years (R. 5, 47), and second that the sale of assets during the process of forced liquidation amounted to the sale of capital assets and not to the sale of inventory (R. 48). Petitioner also claimed, as an alternative to the claim for obsolescence of intangibles, that he was entitled to deduct the loss, under Section 214 (a) (4) of the Revenue Act of 1918, based on cost, of the intangibles of the distillery business which was proscribed by Federal legislation (R. 30, 40).

The Commissioner of Internal Revenue disallowed all of these claims (R. 14-16). The Board of Tax Appeals allowed deductions for depreciation sustained in

the years 1918, 1919, 1920 and 1921 and for obsoleteness or loss of useful value of tangible properties, plant and equipment, except bonded warehouses, which it found occurred in 1921, but decided in favor of the Commissioner as to the other questions involved (R. 28-48). The Circuit Court of Appeals affirmed the decision of the Board (R. 113-118), and from that decision the petitioner applied for a writ of certiorari, which writ was granted on October 14, 1929 (R. 120).

Specification of Errors.

1. The Circuit Court of Appeals erred in holding and deciding that the March 1, 1913, value of the trade marks, trade brands, trade names and good will of a distillery and of a wholesale liquor business were not subject to obsolescence as a result of Federal legislation which proscribed such business.

2. The Circuit Court of Appeals erred in holding and deciding that the depreciated value of the plant and equipment of a distillery was not subject to obsolescence as a result of Federal legislation which proscribed such business.

3. The Circuit Court of Appeals erred in holding and deciding that a taxpayer, sole owner of a distillery, is not entitled to be taxed at the capital gain rate on profit derived from the sale of whiskey held by him as a personal investment for more than two years.

4. The Circuit Court of Appeals erred in holding and deciding that a taxpayer is not entitled to be taxed at the capital gain rate on profits derived from the sale of assets during the process of forced liquidation.

5. The Circuit Court of Appeals erred in failing or refusing to pass upon the question (alternative to

Error 1) whether a taxpayer is entitled to deduct from his gross income as a loss, the cost of the trade marks, trade brands, trade names and good will of his distillery business which was proscribed by federal legislation.

Summary of Argument.

The Revenue Act of 1918, Section 214 (a) (8) enlarges the deduction on account of exhaustion, wear and tear of property used in business by including therein a reasonable allowance for obsolescence. The deduction is additional or supplemental to the usual deduction for depreciation.

The word "property" includes intangibles such as good will. Good will is subject to exhaustion and to obsolescence. Exhaustion and obsolescence relate to economic or commercial life. Wear and tear relate to physical life. The exhaustion and obsolescence do not have to be the result of use in business. The only requirement is that they *be used* in the business. The word "including" is a word of enlargement equivalent to the word "also" and to the conjunction "and", thus creating a new and distinct deduction.

The construction of the Revenue Act of 1918 and subsequent Acts by the Treasury Department confirms the intention of Congress to grant a deduction for obsolescence of good will.

The depreciated value of the plant and equipment of a distillery is subject to obsolescence as the result of prohibiting Federal legislation even though the plant was used for the manufacture of medicinal whiskey during the course of the passage of such legislation, but not after November 23, 1921. It was foreseen in 1918 that there would be an end to the distilling business for

all purposes within a four year period. The deduction is allowed to compensate for a reasonably foreseen loss of useful value prior to natural life and due to economic, commercial or extraordinary causes.

The capital gain provision was passed with the intention of relieving from the burden of the high tax bracket those whose profit was derived from the sale of capital assets held for more than two years. Petitioner's business was that of manufacturing whiskey on contract. He personally held manufactured whiskey for over two years as an investment which was not part of the stock in trade of his distillery business. Such whiskey was, therefore, a capital asset.

Immediately upon the cessation of the usual course of business and the beginning of involuntary liquidation, such whiskey became a frozen capital asset. The term "stock in trade" necessarily means that of a going concern or business. A taxpayer in liquidation has no means of making a profit from recurring transactions or from a continuing business. When his assets are sold he has no further means of replenishing them and thus continuing in business for profit.

If it be held that the intangibles are not subject to obsolescence then a deduction should be permitted on account of the loss thereof occasioned by prohibiting Federal legislation. The loss should be based on cost. When a going business is lost or destroyed its good will is lost or destroyed. The distillery business was destroyed by Federal legislation.

Argument.

I.

INTANGIBLE ASSETS CONSISTING OF TRADE MARKS, TRADE BRANDS, TRADE NAMES AND GOOD WILL OF A DISTILLERY AND OF A WHOLESALE LIQUOR BUSINESS ARE SUBJECT TO OBSOLESCENCE DURING THE YEARS 1918, 1919, 1920 AND 1921 UNDER THE APPLICABLE REVENUE ACTS AS A RESULT OF FEDERAL LEGISLATION WHICH PROSCRIBED SUCH BUSINESSES.

The Revenue Act of 1918 (40 Stat. Part I, p. 1067) Section 214 (a) (8) provided that in computing net income there should be allowed as deductions to individuals

> "a reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;"

A. The Nature of the Deduction.

The reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, as contemplated by the statute, regardless of whether it is referred to as depreciation or as something else, is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, at the end of such useful life, to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date. It excludes any idea of a mere reduction in market value or loss not resulting from normal wear and tear or exhaustion based upon the estimated life of the asset.

The theory of a depreciation allowance is to provide for the restoration of capital over the period of its useful life. Thus, it being the purpose of the statute to allow a restoration of capital over the period of its useful life, it is at once apparent that in certain unusual cases the allowance for depreciation would be inadequate to effect such restoration of the cost or the March 1, 1913 value of an asset. Such unusual cases are those where assets are gradually supplanted and rendered obsolete by new inventions, by changes in style, etc. In such cases when it becomes certain that the assets will, as a result of external factors, within a certain length of time become obsolete or useless, the usual deduction for depreciation will not suffice to return the capital invested or the March 1, 1913 value at the end of the shortened period. To meet this situation Congress supplemented the allowance for "exhaustion, wear and tear of property used in the trade or business" by "including a reasonable allowance for obsolescence".

The Circuit Court of Appeals in the instant case held that

> "The clause, 'including a reasonable allowance for obsolescence,' enlarges the allowance made for exhaustion, wear and tear of property used in the business. The first allowance is made for depreciation resulting from exhaustion, wear and tear, or the use of the property in the business. The second allowance is made for depreciation resulting from obsolescence, or the disuse of the property in the business. The cause of depreciation in the one case is from use and in the other from disuse. They are antithetical. The property, however, is the same in both cases and must be such as may be, or has been, subject to exhaustion, wear and tear,

and obsolescence. Is good will such property as the Congress had in mind? Does it have the attributes implicit in the language used?" (R. 114).

We respectfully submit that obsolescence is not the result of disuse but is the result of lapse of time, changes in the art, prohibition legislation, etc. Property may be in the state of becoming obsolete and still be used in the business. The deduction should be allowed when the life of the asset has a definite termination due to external factors not necessarily the result of use in the business even as a deduction for depreciation is allowed while the property is still in use.

The Circuit Court of Appeals for the Eighth Circuit in the case of *Red Wing Malting Co. v. Willcuts,* 15 Fed. (2d) 626, in commenting upon this section held:

> "It would seem quite apparent, therefore, that Congress was not intending to add a new and independent deduction. It was merely trying to provide the restoration of capital value of a depreciable asset over the period of its useful life by allowing something, known as obsolescence, as an additional element to exhaustion, wear, and tear. This legislative history sustains, we think, the conclusion to which we are forced that the phrase 'including a reasonable allowance for obsolescence' is one of specification and enlargement; that it is closely connected with and relates to the subject-matter of the other phrase of said subsection (7), and applies only to such property therein designated used in the business as is subject to exhaustion, wear, and tear."

Petitioner contends that obsolescence is an element of exhaustion and that intangible assets are as much

subject to exhaustion as are tangible assets, and further that the exhaustion including obsolescence need not be caused by use in the business, but that the deduction is allowed if the assets, subject to exhaustion and obsolescence, are used in the business.

The determination of the question therefore depends upon the question whether good will is property which is subject to exhaustion and obsolescence.

B. Good Will is Property Within the Purview of Section 214 (a) (8) of the Revenue Act of 1918.

The word "property" as used in the Act is not used in any restricted sense. *Lynch v. Alworth-Stephens Company,* 267 U. S. 364. The Act does not specify any particular property. Therefore, all kinds of property, real, personal and mixed, tangible and intangible, must be held to be included in the term.

Good will has been best defined by Mr. Trammell in his dissenting opinion in *Appeal of Manhattan Brewing Co.,* 6 B. T. A. 952, as follows:

> " 'Good will' has been defined as being the advantage or benefit which is acquired by an establishment beyond the mere value of capital stock, funds or property employed therein in consequence of the general public patronage and encouragement which it receives from the constant or habitual customers on account of its local position, or from celebrity or reputation for skill or affluence or punctuality, or from other accidental circumstances or necessities or even from ancient partialities or prejudices. *Brown v. Benzinger,* 118 Md. 29, 84 Atl. 79; *Haugen v. Sundseth,* 106 Minn. 129,

118 N. W. 666; *Goetz v. Ries,* 123 N. Y. S. 433; *Johnson Co. v. Roberts,* 159 N. Y. 70, 53 N. E. 685; *Morgan v. Perhamus,* 36 O. S. 517; *Storey on Partnership,* Sec. 99".

Good will is property in and of itself. It is intangible in nature. It is something that may be the subject of ownership, may be transferred, and may be protected by law. The term "property" includes good will. The importance of good will property has been universally recognized. *28 Corpus Juris,* 730; *Metropolitan Bank v. St. Louis Dispatch Co.,* 149 U. S. 436; *Coca Cola Bottling Co. v. Coca Cola Company,* 269 Fed. 796; *Washburn v. National Wall Paper Co.,* 81 Fed. 17.

Good will, however, has no existence except in connection with a going business and it may be bought and sold in connection with a going business as an incident or element thereof. *Camden v. Stuart,* 144 U. S. 104; *Sawilowsky v. Brown,* 288 Fed. 533.

Trade marks, trade brands and trade names are likewise property of an intangible nature. They cannot be separated from good will as it is impossible to allocate the value of the intangibles. They are in fact a part of and included in good will.

C. Good Will Is Property Which Is Subject to Exhaustion and to Obsolescence. The Deduction Is Not Limited to Assets Which Are Subject to Wear and Tear by Use in the Business.

"Obsolescence is defined in *Webster's New International Dictionary* as 'state of becoming obsolete' and obsolete is defined as 'no longer in use'; 'neglected'. Obsolescence can be distinguished from

'wear and tear' in that wear and tear refers to the physical condition, while obsolescence refers to disuse and disappearing value arising from some extrinsic or external causes, such as progress in an art, change of style, or legislation. Machinery may be in good physical condition, but, by reason of change of style or progress in the art in which it is employed, be obsolete or in a state of obsolescence. It should be noted that obsolescence is defined as the state of becoming obsolete, and does not necessarily imply that the disuse should be completed." *Manhattan Brewing Company,* 6 B. T. A. 952:

"Exhaust" is defined in the *Century Dictionary*:

"To use up or consume completely; expend or make away with the whole of; cause the total removal or loss of."

The word "exhaustion" is used in the Act in contradistinction to "wear and tear". Exhaustion results not from use but from external factors. Wear and tear from use. Certain assets become exhausted by the mere efflux of time. Leases, contracts, patents, and franchises are of this class, and deductions on account of the exhaustion, including a reasonable allowance for obsolescence of such assets, have been uniformly allowed. *Van Kannel Revolving Door Co. v. Commissioner,* 11 B. T. A. 1209; *Kentucky Tobacco Products Co. v. Lucas,* 5 Fed. (2d) 723 (D. C. W. D. Ky.); *Lassen Lumber & Box Co. v. Blair,* 27 Fed. (2d) 17 (C. C. A. 9th C.); *Lynch v. Alworth-Stephens Company, supra; Henrici Co. v. Reinecke,* 3 Fed. (2d) 34; *Kaufmann-Strauss Co. v. Lucas,* 12 Fed. (2d) 774. Articles 163 and 167 of Regulations 45, 62, 65, and 69 and Articles 203 and 207 of Regulations 74 issued under

the Revenue Acts of 1918, 1921, 1924, 1926 and 1928, respectively. T. D. 3760, IV. 2, C. B. 154.

While it may be said as a general rule that good will cannot be sold and has no existence separate and apart from a going business, it is recognized as an asset. Frequently it is the most valuable and the greatest income producing factor. Such was the situation in the instant case. The reputation of Large whiskey was of the very best. It was of excellent quality. Its sale was restricted to wholesale liquor dealers. It had won the first prize at numerous world fairs (R. 33).

Good will is a separate element forming part of the property and assets of an enterprise. It is capable of a separate valuation and may be protected by law. It may be entered separately on the books. It increases the total value of the business, but does not increase the value of the tangible assets segregated from the business. It is not indissolubly connected with specific tangible property. *Washburn v. National Wall Paper Company, supra.* Its value is not dependent upon the value of other assets. It is recognized as a separate element for the purpose of invested capital in the Revenue Act of 1917, Act of October 3, 1917, ch. 63, Sec. 207 (a), 40 Stat. 300; in the Revenue Act of 1918, Act of February 24, 1919, ch. 18, Sec. 325 (a) and Sec. 326 (a) (4) (5), 40 Stat. 1057; and in the Revenue Act of 1921, Act of November 23, 1921, c. 136, 42 Stat. 227. (see appendix).

Franchises like good will are intangible property. This court has held that payment under condemnation proceedings must be made for the destruction of a franchise to collect tolls for use of a dam and lock.

Monongahela Navigation Co. v. United States, 148 U. S. 312.

Let us assume a parallel case. Suppose that Congress had passed an Act appropriating the lock and dam of the Monongahela Navigation Company for public use, or suppose the State of Pennsylvania had passed an Act appropriating a privately owned bridge for public use, in each case to become effective two years thereafter, thus determining a definite life for the respective franchises. Upon the passage of the Acts it would be known that the franchises would be destroyed at the end of two years and the value thereof lost. How can it be logically argued that these franchises are not during those two years in a state of obsolescence? The obsolescence, however, is caused by the passage of legislation, an external factor, and not by use in the business. Neither can it be logically argued that the franchises are not used in the businesses. The earnings are not predicated upon the physical property alone. Without the franchises to collect tolls from what source would income flow? The use of good will in either a distillery or a wholesale liquor business is analogous. In the distillery business the tangible property produces the product. The good will sells it. In the wholesale liquor business the tangible property represents the place and the product. The good will is the reputation of both and the underlying cause of the sales from which the income flows. In both cases both the tangible and intangible assets are property used in the business to produce income.

Therefore, good will, like any other asset, can be destroyed if the business is destroyed. It can become obsolete if the business becomes obsolete. It can be the subject of obsolescence if the business is in the process or state of going out of use or becoming obsolete. Un-

der ordinary circumstances the life of such intangibles is indefinite and indeterminable. But ordinary circumstances are not present in this case. The passage of the Eighteenth Amendment by Congress created a most extraordinary circumstance. It was then reasonably expected, in fact it was a foregone conclusion, that the Amendment would be ratified, and it was reasonably expected that the distillery business and the wholesale liquor business would soon be matters of history, and that the value of the good will of such businesses would, within a short time, be destroyed.

While good will may not be subject to exhaustion, wear and tear including obsolescence by use in a trade or business the statute, however, does not require that the exhaustion, wear and tear, including obsolescence must be the result of use in the trade or business, but only requires that such assets *be used* in the trade or business in order to come within the provision.

The Revenue Act of 1913 provided for a deduction on account of the depreciation of property by use, wear and tear. The Revenue Act of 1916 provided for a deduction for the exhaustion, wear and tear of property "arising out of its use or employment in the business or trade." It is indeed significant that the Revenue Act of 1918 passed after Congress had had an opportunity to observe the workings of the prior Acts and the administration thereof by the Treasury Department, omitted the words "arising out of its use or employment in the business or trade".

In *Kentucky Tobacco Products Co. v. Lucas*, 5 Fed. (2d), 723, the Court held

> "Congress certainly knew that there are many species of property, such as the contract in this

case, copyrights and patents, which are used in connection with the business which produces the income taxed, and which depreciate in value as the end of their life approaches, and yet which lose none of their value as the result of their use or employment in the business. It is a fair deduction to conclude that the difference in the corresponding sections of the acts of 1916 and 1918, heretofore referred to, arose out of the desire of Congress to put such contracts and property rights upon the same footing as is given by the act of 1916 to property which is exhausted by reason of its use in the business. Whatever may have been the purpose of Congress, however, it remains that there is a very substantial difference between the corresponding provisions of the two acts, and the court is convinced that the act of 1918 authorizes a *reasonable deduction from gross income to cover exhaustion of property used in the business, whether that exhaustion is caused by the use itself or from other causes,* * * *"

Why should good will not be subject to the same exhaustion and obsolescence as patents, leases, etc.? It is not the use in the business which creates obsolescence. It is usually the development of the art in that particular industry. The invention of new apparatus, the changing trend of the times, or the passage of prohibiting legislation. The obsolescence of electrical equipment is a shining example. Ladies' clothing, particularly hats, dresses, and coats, does not become obsolete by use but by change in styles. The old "snub nose" Franklin automobile is now obsolete not because of use but because of the change in body styles. Likewise the old model "T" Ford.

The test is that the property, whether tangible or intangible, must be used in the trade or business to distinguish it from property not so used, and, if the property is used in the trade or business, the deduction for obsolescence should be allowed, no matter what causes the obsolescence or upon what kind of property it operates.

If the deduction on account of the obsolescence of property is held to be allowable only in cases where it is becoming obsolete by or on account of its use in the trade or business, the effect would be to eliminate the deduction from the statute because intangible property does not become obsolete by or as the result of use. Obsolescence is different from exhaustion, wear and tear in that it is the shortening of the useful life of an asset on account of economic conditions, new inventions, prohibiting legislation, and other causes which have no connection with the physical use of the asset. Obsolescence relates to economic or commercial life rather than physical life. Certain assets become exhausted by the mere efflux of time. Leases, contracts, patents, and franchises are of this class and deductions on account of the exhaustion of such assets are permitted by the statute and by the decisions. *Such assets become exhausted not by the use to which they are put but because they have a definite life.* The amount of use does not effect the amount of the exhaustion which takes place.

We submit the deductions should be allowed with respect to all assets used in the business when it is shown that they are approaching the end of their useful life as a result of either exhaustion or wear and tear, and if the element of obsolescence is present the deduction should also include it so that by the time the

assets are abandoned or lost the capital value will have been returned out of earnings.

If the statute be carried to its logical conclusion, an asset having an indefinite life when acquired but which thereafter becomes limited and definite by Federal legislation is as much subject to obsolescence as an intangible asset having a definite life when acquired, such as patents, contracts, leases, etc., deductions for which have been uniformly allowed.

In so far as the wholesale liquor business of this taxpayer was concerned, he was absolutely forced to give up and abandon an established business in which these intangible assets were used and were income-producing factors.

In so far as the distillery business of this taxpayer was concerned, the passage of the Eighteenth Amendment by Congress on December 18, 1917, and the ratification thereof by three States, two of which were considered doubtful, by January 31, 1918, created a universal belief that the manufacture of whiskey would soon be absolutely prohibited. This belief was borne out by the passage of the Willis-Campbell Act on November 23, 1921. In the meantime and during the years over which the obsolescence should be spread, whiskey could be manufactured for medicinal purposes but a definite life of the distillery properties had been ascertained.

Furthermore the effect of the passage of the Eighteenth Amendment completely revolutionized the petitioner's distillery business and absolutely destroyed the good will. Whiskey was no longer a beverage. The former clientele of the petitioner were forced out of business. There was no longer an open market for

their product. All sales of whiskey thereafter were made under the supervision and restriction of the United States Government. The good will which petitioner had built up and which existed as a part of his distillery business for beverage whiskey did not exist as a part of the medicinal whiskey business. An entirely different and foreign good will had to be built up in that new business. The customers were different. The market was an entirely new market inexperienced and unqualified to judge good whiskey. After prohibition it was not the quality of the whiskey which counted with the customer nor even the quantity, but only the ability to purchase and any kind of whiskey answered the purpose. The only requirement was that it should be stimulating. The new trade did not know a blended whiskey from a straight or a Rye from a Bourbon.

See:

Dissenting opinion of Mr. Trammell in

Appeal of Manhattan Brewing Co., supra.
Haberle Crystal Springs Brewing Co. v. Clarke,
30 Fed. (2d), 219 (C. C. A. 2d C., now before this Court on Writ of Certiorari.)

As we have hereinbefore argued, the intangibles in both the petitioner's distillery and wholesale liquor businesses were used in the businesses. A large part of the success of both businesses was predicated upon the use of the intangibles. The intangibles in the wholesale liquor business were absolutely destroyed when the Eighteenth Amendment became a law, and that destruction was reasonably foreseen by January 31, 1918. As to the distillery business, the destruction became absolute upon passage of the Willis-Campbell Act on No-

vember 23, 1921, and was likewise reasonably foreseen by January 31, 1918.

D. THE WORD "INCLUDING" IS A WORD OF ENLARGEMENT, HAVING THE SAME MEANING AS "ALSO" AND AS THE CONJUNCTION "AND".

The Revenue Act of 1918 was enacted in the light of the Revenue Acts of 1909, 1913 and 1916, and in respect of the deductions allowed therein was molded closely after those Acts; adding as it were new subjects as deductions as knowledge increased as to the effect of the application of the Acts to different branches of business. By way of illustration reference is made to the Revenue Act of 1909, Section 38, Par. 2nd, which provides that

> "all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, * * *"

are deductible, and to the Revenue Act of 1913, which contains this provision:

> "all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any * * *"

and to the Revenue Act of 1916, Part II, Sec. 12, Second, which provides:

> "all losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and

production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the production thereof which has been mined and sold during the year for which the rate and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury."

The present participle "including" is used in the same manner in the Act of 1918. It would be pedantic to argue that the word "including" as used in the Acts of 1909, 1913 and 1916 did not introduce a new kind of deduction different from that referred to in the words which immediately preceded it.

In the foregoing Revenue Acts a deduction for depreciation or exhaustion, wear and tear, was included in the deduction allowed for losses. In the Revenue Act of 1918, however, the deduction was disassociated from the loss provision and was given an entirely separate classification.

In Sections 214 (a) (1) and 234 (a) (1) of the Revenue Act of 1918 the present participle "including" and the words "and including" are used to introduce new subjects in addition to those which immediately precede them.

The present participle "including" has been used in many tariff acts, to-wit:

Tariff Act of July 24, 1897, c. 11, Sec. 2, 30 Stat. 197, Par. 545,

"diamonds and other precious stones, * * * including miners', glaziers' and engravers' diamonds * * *"

Tariff Act of July 24, 1897, c. 11, Sec. 2, 30 Stat. 197, Par. 339,

"embroideries and all trimmings, including braids, edgings, * * *"

Tariff Act of July 24, 1897, c. 11, Sec. 2, 30 Stat. 197, Par. 699,

"logs and round unmanufactured timber, including pulp woods, fire wood, * * *"

The word has always been construed as being the equivalent of "also". *Sullivan Machinery Co. v. United States,* 168 Fed. 561; *Hiller v. United States,* 106 Fed. 73; *United States v. Pierce,* 147 Fed. 199.

The Bureau of Internal Revenue has consistently construed the word "including" to have the same meaning as the conjunction "and".

Regulations 33, Article 147 as to losses.
Regulations 33, Article 159 as to depreciation.
Regulations 45, Article 161 as to depreciation.

This is well illustrated by the following quotation from two of the above cited regulations:

Regulations 33, Article 159:

"Section 12, Item 'Second', authorizes corporations to deduct from the gross amount of their income received within the year all losses actually sustained and charged off within the year, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade.

"Depreciation as here used must be differentiated from the depletion, obsolescence, and other losses elsewhere provided for in these regulations."

Regulations 45, Article 161:

"A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence."

Regulations 74 promulgated under the Revenue Act of 1928 provides in Article 206 that the deduction for obsolescence shall be in addition to the deduction for depreciation as follows:

"Obsolescence.—With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost (or other basis) at the end of its economic term of usefulness, a reasonable deduction for obsolescence, *in addition to depreciation,* may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and can not be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due." (Italics ours).

If, therefore, the word "including" is a word of addition a different deduction is authorized for obsolescence not dependent to any extent on exhaustion, wear and tear, and as we have previously shown, goodwill is subject to obsolescence even as other assets, whether tangible or intangible.

E. THE CONSTRUCTION OF THE REVENUE ACT OF 1918 BY THE TREASURY DEPARTMENT CONFIRMS THE INTENTION OF CONGRESS TO GRANT A DEDUCTION ON ACCOUNT OF OBSOLESCENCE OF INTANGIBLES, AND SUCH CONSTRUCTION HAS THE FORCE AND EFFECT OF LAW.

The Bureau of Internal Revenue, by and including the several agencies thereof whose duty it was to administer the Revenue Act of 1918, has construed Section 214 (a) (8) of that Act to permit deductions on account of obsolescence of intangibles.

In Law Opinion 862, Cum. Bul. No. 1, page 127 (1919), the office of the Solicitor of Internal Revenue held that a deduction was permitted for the obsolescence of a wine vineyard rendered obsolete by prohibition legislation, said obsolescence to be distributed over the period elapsing between the passage of the prohibition measure and the date when abandonment occurred.

In T. B. R. 44, Cum. Bul. No. 1, page 133 (1919), the Advisory Tax Board recommended that distillers and dealers in liquor be allowed to deduct a reasonable allowance for obsolescence of good will, trade marks, or trade brands, the value of which was impaired or destroyed by prohibition legislation. Upon the strength of this recommendation Regulations 45 were revised by the Treasury Department. (T. D. 2929, Cum. Bul. 1, page 133, 1919).

In O. D. 298, Cum. Bul. No. 1, page 138 (1919), the Rules and Regulations Section of the Bureau of Internal Revenue held that deductions on account of obsolescence of intangibles allowed distillers and dealers in liquor were also applicable to brewers.

In O. D. 472, Cum. Bul. No. 2, page 141 (1920), the same section held that obsolescence of good will would be allowed in the case of the discontinuance of a going business because of the exhaustion of its source of supply, provided the good will would not be valuable in another business after the termination of the business in which the taxpayer was engaged.

Bulletin F, "Depreciation and Obsolescence", issued by the Treasury Department on August 31, 1920, contains information relative to the obsolescence of intangible assets of brewers, distillers and dealers in liquor and permits the deduction on account of obsolescence of intangibles including good will if the intangibles were in fact destroyed or became obsolete.

In O. D. 818, Cum. Bul. No. 4, page 178, the Rules and Regulations Section held

> "In the case of liquor dealers the useful life of whose intangibles, such as good will, trade marks and trade brands, was definitely limited as the result of prohibition legislation an allowance for obsolescence is permissible."

We have been unable to find any regulations or published ruling or decision of the Commissioner under the Revenue Act of 1918 on the question of the obsolescence of intangible assets which is contrary to the above opinions and rulings. There are rulings and opinions of the Commissioner, however, to the effect that when the taxpayer, instead of abandoning his business on the

effective date of prohibition legislation, continues in some other business in which the Commissioner considered that the good will continued and was not destroyed, no allowance should be made on account of the obsolescence of such good will; in other words, the Treasury Department has challenged the application of the rule but never the rule itself.

The Regulations also provided for a deduction on account of depreciation of intangibles. Article 161 of Regulations 45 provides:

> "A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence."

Article 163 of Regulations 45 provides:

> "Depreciation of intangible property.—Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses, and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are

fully shown in the return or prior thereto to the satisfaction of the Commissioner."

The latter Article when originally issued contained the following provision:

"There can be no such allowance in respect of good will, trade names, trademarks, trade brands, secret formulæ, or processes."

In 1919 after T. B. R. 44, *supra,* was published the Regulations were revised and the above clause stricken out. (T. D. 2929, Cum. Bulletin 1, page 133.) The Regulations were approved by the Secretary of the Treasury. Article 163 thereafter stood unchanged until after the decision of the Circuit Court in the case of *Red Wing Malting Co. v. Willcuts,* 15 Fed. (2d) 626, when T. D. 3980 was issued on February 23, 1927, holding that no deduction could be taken for obsolescence of good will. While they were in full force and effect the Revenue Acts of 1921, 1924 and 1926 were passed containing provisions corresponding to those of the 1918 Act and enacted without the slightest change in phraseology. The Revenue Act of 1926 was passed soon after the decision of the District Court in the Willcuts case had been handed down and it is plausible to assume that the framers of the Act did not have in mind that decision or that that decision had not been called to their attention.

The Regulations, Treasury Decisions, and Rulings hereinbefore quoted are entitled to very great respect. *Edwards v. Darby,* 12 Wheat. 206 (1827). They are not to be disregarded without the most cogent and persuasive reasons. *Robertson v. Downing,* 127 U. S. 607, 613. And when Congress in subsequent Acts makes no change in the phraseology of the section construed, the

construction of the Treasury Department must be presumed to have been adopted by Congress and to have the force and effect of law. *New Haven Railroad v. Commerce Commission,* 200 U. S. 361, 401; *Copper Queen v. Arizona Board,* 206 U. S. 474, 479; *United States v. Boston & Maine Railroad,* 279 U. S. 732.

F. As to the Spread of Obsolescence.

Your Petitioner respectfully submits that under the facts in the instant case the spread of the deduction on account of obsolescence of the intangibles of the distillery, if this Honorable Court finds that he is entitled to such deductions, should be over the period from January 31, 1918, to November 23, 1921, and the spread of the deduction on account of obsolescence of the intangibles of the wholesale liquor business should be over the period from January 31, 1918, to January 16, 1920.

The Eighteenth Amendment was proposed by Congress on December 18, 1917. By January 31, 1918, it had been ratified by three States, Massachusetts, Maryland and Kentucky, the first two of which were considered doubtful States, by a decisive vote (T. B. R. 44, *supra*), and it was then reasonably foreseen that it would be passed and that these businesses would be destroyed.

The wholesale liquor business was absolutely destroyed on January 16, 1920, when the Amendment became effective. The rulings of the Department hereinbefore referred to, support this contention.

The facts as to the termination of the distillery business are somewhat different. Medicinal whiskey was permitted to be manufactured until November 23,

1921, and on that day the business of distilling whiskey came to an absolute end. The end had been foreseen by the general public and by this petitioner in particular (R. 35). We have contended that these intangibles would have no value for the distillation of medicinal whiskey yet we submit that the termination of the spread of the obsolescence should be November 23, 1921.

The Treasury Department in the rulings hereinbefore cited and relied upon held that the period for the spread of obsolescence in such cases (both distillers and wholesale liquor dealers) should be from January 31, 1918 to the date of actual discontinuance of the business, in any event not later than January 16, 1920, the date when the Eighteenth Amendment became a law. The spread as to the distillery business should therefore either be from January 31, 1918, to November 23, 1921, or from January 31, 1918, to January 16, 1920.

The respondent in the Circuit Court of Appeals did not argue either in his brief or in his oral argument that the deduction for obsolescence should not be allowed in the years claimed by the petitioner, and the Circuit Court of Appeals held that there was no dispute as to the amount of the deduction, if any, to which the petitioner was entitled (R. 114).

II.

THE DEPRECIATED VALUE OF THE PLANT AND EQUIPMENT OF A DISTILLERY IS SUBJECT TO OBSOLESCENCE SPREAD OVER THE PERIOD FROM 1918 TO 1921, INCLUSIVE, AS A RESULT OF FEDERAL LEGISLATION WHICH PROSCRIBED SUCH BUSINESS.

The Board allowed petitioner a deduction in 1921 on account of the loss of useful value or obsoleteness of the depreciated value of all plant and equipment except bonded warehouses, and allowed a deduction in 1921 and 1922 for depreciation including obsolescence of the bonded warehouses based on the number of barrels withdrawn (R. 45). The Circuit Court affirmed the Board. The Board of Tax Appeals and the Circuit Court, however, held that because the plant and equipment were being used in the manufacture of medicinal whiskey until the passage of the Willis-Campbell Act they were not obsolete.

The manifest error, we submit, is in the assumption that the deduction was for obsoleteness rather than for obsolescence. A deduction for obsolescence is valid even though the property is still being used in the business. It is allowed to compensate for a reasonably foreseen loss of useful value prior to natural life and due to economic or commercial causes.

As the evidence shows there was no use of the distillery or any part thereof except the warehouses after November 23, 1921, and there is no doubt in our minds that the said warehouses during the years 1918, 1919, 1920 and 1921 were in the process of becoming obsolete. The prohibition amendment put them into a position of disuse. On January 1, 1922, the four warehouses, which had a total capacity of 55,000 barrels, contained only 27,393 barrels. Not a wheel was turned after November 23, 1921.

After the passage of the Eighteenth Amendment the public at large foresaw the complete downfall of the liquor business and so the passage of the Willis-Campbell Act was not an unforeseen event. It was to be expected in the natural course of events that such an Act would be passed in order to make the Eighteenth Amendment effective and in view of the activities of the prohibition element in Congress. It was not only the distiller that foresaw the elimination of the distilling business, but it was also well known to the general public that the distilling business would be prohibited within a period of about four years. Consequently obsolescence commenced on the physical properties of the distilling business in the year 1918, and ended in the year 1921. In the meantime, and during the years over which the obsolescence should be spread, whiskey could be manufactured for medicinal purposes but a definite life of the distillery properties had been ascertained, and it was almost certain that the manufacture of whiskey would be prohibited within the near future. The conclusion which the petitioner reached in 1918 that the whiskey business would be prohibited within four years was borne out by subsequent events.

A taxpayer is entitled to a deduction on account of obsolescence of tangible properties. *American Valve Company,* 4 B. T. A. 1204; *Manhattan Brewing Company,* 6 B. T. A. 952; the Opinion of the Circuit Court in the instant case, 31 Fed. (2d) 675 (R. 116).

The question as to the spread of the obsolescence is the same in respect to tangible properties as to intangible properties, and is argued under Point I, F *supra.*

III.

PROFITS DERIVED FROM THE SALE OF "OLD WHISKEY" SHOULD BE TAXED AT THE CAPITAL GAIN RATE.

The theory of the petitioner in regard to this point is first, that the whiskey had been held by him as a personal investment for more than two years, and was not part of his stock in trade, and, second, that the sale of assets during the process of forced liquidation amounts to the sale of capital assets and not to the sale of inventory or stock in trade.

A. THE "OLD WHISKEY" WAS A PERSONAL INVESTMENT OF THE PETITIONER, HELD BY HIM FOR MORE THAN TWO YEARS, AND WAS NOT PROPERLY PART OF HIS STOCK IN TRADE.

Section 206 (a) (6) of the Revenue Act of 1921 provides:

> "The term 'capital assets' as used in this section means property acquired and held by the taxpayer for profit or investment for more than two years (whether or not connected with his trade or business), but does not include property held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year."

Section 206 (b) provides that the taxpayer shall, at his election, in a case where he derives a capital net gain, be taxed at the rate of 12½% thereof.

The petitioner's business before prohibition was that of distilling and selling whiskey on contract at or before the time it was manufactured (R. 31). His

business was not that of manufacturing whiskey to be held in bond for future sale.

On November 23, 1921, the petitioner stopped the manufacture of medicinal whiskey and began the liquidation of his business.

The "Old Whiskey" account represented whiskey which was transferred from the distilling business to a personal investment account of the petitioner, who had been in the habit of carrying his personal investment accounts on the books of The Large Distilling Company for years. The whiskey sold from this account in 1922 had been carried for at least four or five years.

The stock in trade of the Large Distilling Company consisted of grain, rye and barley malt, empty whiskey barrels, cooperage supplies, supplies for the bottling house, material of that kind and everything else required by a distillery to manufacture whiskey. Automobiles were carried in the books of account (R. 74).

It was not the business of The Large Distilling Company to manufacture, age, and hold the manufactured whiskey in bond for subsequent sale. There is a line of demarcation between first, the manufacture of whiskey on contract and the sale thereof before it is actually manufactured, and, second, the manufacture of whiskey not on contract, the aging and holding of the same in bond for future sale. In the second instance the manufactured whiskey is stock in trade or inventory of the distiller.

In two somewhat analogous situations the Treasury Department has given the taxpayer the benefit of the capital gain rate.

In I. T. 2297, Cum. Bul. V-2, page 109, it was held:

> "However, if a (real estate) dealer can establish that any of the property sold by him was held primarily for investment rather than for sale, the provisions of Section 206 (b) of the Revenue Act of 1921 and Section 208 (b) of the Revenue Act of 1924 will apply to the taxation of the profits realized from the sale thereof."

In I. T. 2502 Internal Revenue Bulletin, Vol. VIII, 42-4389, page 3, it was held:

> "The net gain resulting from the sale of shares of stock held for more than two years by a dealer in securities may be treated as capital net gain subject to tax under section 101 of the Revenue Act of 1928, provided the stock was held by such dealer primarily for investment and was not a part of the securities traded in."

B. ALL STOCK IN TRADE OR INVENTORY BECAME A CAPITAL ASSET IMMEDIATELY UPON THE CESSATION OF THE USUAL COURSE OF BUSINESS AND THE BEGINNING OF INVOLUNTARY LIQUIDATION.

This is an involuntary and not a voluntary liquidation. It was forced upon petitioner by the Eighteenth Amendment and National Prohibition Legislation, and especially by the Willis-Campbell Act of November 23, 1921. The distillery business of the petitioner has been in liquidation since 1921 (R. 37).

Before prohibition, one who bought and sold whiskey could lawfully buy or sell from or to anyone in the open market. After prohibition, the purchase or sale of whiskey could only be made by one having a permit to sell, to one having a permit to buy.

When the petitioner, in 1922, sold his "Old Whiskey", he was selling capital assets in liquidation. It was not intended, as shown by the Act as well as the reports of the various committees in Congress at the time of the passage of the Revenue Act of 1921, that the taxpayer should be subject to a normal and surtax on income realized from the sale of capital assets. Of course, it was intended that the stock in trade of a going concern should be subject to normal and surtax rates, but it certainly was not intended that capital assets should be subject to other than the capital gain rates, if the taxpayer elected to be taxed on that basis.

A company cannot have a stock in trade if it is in the process of liquidation. The term "stock in trade" means the merchandise of a going concern or business. This petitioner was not operating a going concern and has not been since November 23, 1921. Therefore, he cannot have a stock in trade. The minute a business ceases to operate, its stock in trade becomes a *frozen asset* and the profit on the sale of such assets, if held for a period of two or more years, comes squarely within the provisions of Section 206. The fact that this distiller was forced into liquidation by the Prohibition Acts, thereby *freezing* his assets so that it was no longer possible for him either to manufacture his product or stock in trade or to sell it to the public, must be given consideration.

The distiller is forced to liquidate slowly. He cannot sell his assets direct to the public. He must await the pleasure of the Prohibition Unit in the approval of all permits, etc., necessary to sell such assets. The distiller's former customers have also been forced out of business. The sales made since January 16, 1920, are to permittees of the Government, who prior thereto did no business whatsoever with the distiller.

It has been contended that the distiller entered into a new business since January 16, 1920, *i. e.*, that of selling to the permittees. This is contrary to the facts. The distiller has not entered into a new business. He is liquidating his assets through the channels prescribed by the Government which, of necessity, must be slow, due to the restrictions and regulations governing such sales.

If the contention that the distiller is in a new business since November 23, 1921, is correct, why is it that he can no longer distill his product? What is his new business? If it be a merchandising business, how can he purchase or distill his whiskey? It cannot be done. Therefore he must be in the process of liquidation. This is the only answer to the question. A merchandising business consists of purchase and sales. A manufacturing business consists of manufacture and sales. A brokerage business consists of purchase and sales on commission. It matters not what type of business you may consider, there are two parts to the business: that of purchase and that of sale, or manufacture and sale, as the case may be. After November 23, 1921 the distiller had only one of these parts, that of sale, and even that was restricted, and there was no replacement of the goods sold and therefore no stock in trade.

If not entitled to the benefit of the capital gain provision, the petitioner is left in the absurd position of carrying on a business without having a source of supply with which to replenish his stock in trade.

We have made a careful and thorough search of the decisions but we have been unable to find any reported cases holding either for or against our contention. This question must, then, be decided upon the

law as developed by the application of common sense to the facts of the case, for law is, in its inception, only the application of common sense to the particular facts. If there be any doubt it must be resolved in favor of the taxpayer.

This question, whether stock in trade or inventory becomes a capital asset immediately upon the cessation of the usual course of business and the beginning of forced liquidation, is one of first impression.

It involves a construction of Section 206 of the Revenue Act of 1921, a beneficial provision to aid and assist those who have capital assets for sale. It was passed with the intention of relieving from the burden of the high tax brackets, those whose profit was derived from the sale of capital assets or from a single transaction and not from recurring transactions, or a continuing business. A taxpayer in liquidation has no means of making a profit from recurring transactions or from a continuing business. When his assets are sold he has no further means of replenishing them and thus continuing in business for profit. Hence Congress said he shall not be required to pay the high tax. A decision to the contrary, we respectfully submit, would violate the spirit of the act and the intent of the legislative body.

IV.

IF INTANGIBLE ASSETS ARE NOT SUBJECT TO OBSOLESCENCE, A DEDUCTION ON ACCOUNT OF THE LOSS OF SAID INTANGIBLES, BASED ON COST, AS A RESULT OF PROHIBITING FEDERAL LEGISLATION SHOULD BE ALLOWED.

This question is alternative to the first and principal question involved. Petitioner contended that if he were not entitled to deductions from gross income on account of obsolescence of intangibles, he was entitled to a deduction in the year 1919 on account of the loss, based on cost which was less than the March 1, 1913, value of the intangible assets of his distillery business.

Petitioner claims this deduction under Section 214 (a) (4) of the Revenue Act of 1918, which provided:

> "(a) that in computing net income there shall be allowed as deuctions: (4) losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;"

The Large Distilling Company as hereinbefore set forth was engaged in the business of distilling Rye whiskey under contract with wholesale liquor dealers, and during the years prior to 1919 had secured a large and valuable clientele both among the consumers and wholesale and retail liquor dealers. This clientele used Rye whiskey as a beverage and all the efforts of the petitioner were bent towards making Large Whiskey a recognized beverage. The petitioner expended through advertising, services, etc., $578,281.12 for this purpose. While the Board made no finding of fact that such was the actual cost, although requested to do so by petitioner (R. 25 (33, 34, 35)), it did find as a fact that the expenditures for advertising and leakage had been

made, that the petitioner drew no salary, and that his services were worth $15,000.00 per year (R. 33, 34, 35). This expenditure constituted a capital asset and was completely lost on the 16th day of January, 1919, when the Eighteenth Amendment was ratified. Thereupon whiskey became a medicine and not a beverage. The clientele of the petitioner was forced out of business. The good will of both his distillery and wholesale liquor business was lost. The intangibles of The Large Distilling Company, which had been built up since 1796, were absolutely lost. The good will of a distillery manufacturing whiskey for beverage purposes would be of no value to a distillery manufacturing whiskey for medicinal purposes.

In *Jack's v. Commissioner,* 18 B. T. A. .... (not yet reported) decided December 6, 1929, the Board of Tax Appeals held that the good will of a downtown New York restaurant had been "destroyed as a result of the adoption of the prohibition amendment."

The respondent has admitted in his brief (pages 5, 28) filed in *Clarke v. The Haberle Crystal Springs Brewing Co.,* No. 68 October Term, 1929, that a deduction under this section for the loss of the property is allowable in the year in which it becomes obsolete.

The testimony supports the petitioner's contention as to the cost of the intangibles (R. 85, 87, 91, 92).

The Board of Tax Appeals held as a matter of law that the ratification of the Eighteenth Amendment on January 16, 1919, did not destroy the business of The

Large Distilling Company, or render its intangibles obsolete because it continued to manufacture whiskey for medicinal purposes until November, 1921. The Board failed to specially find as a fact the cost of the intangible assets although requested so to do by petitioner (R. 25).

The question was fairly and properly presented to the Circuit Court of Appeals (R. 58, 64), but that court failed to pass on the question in any manner whatsoever.

If petitioner is denied both his first point and this alternative point he is left in the anomalous position of having lost a valuable capital asset without the right to take any deduction whatsoever therefor from his gross income in the year he sustained the loss.

V.

PRINCIPLES OF CONSTRUCTION APPLICABLE.

The plain, obvious, and rational meaning of a statute is always to be preferred. *Lynch v. Alworth-Stephens Company,* 267 U. S. 364, *supra.* This principle applies to the construction of both Section 214 (a) (8) as to obsolescence of intangibles and Section 206 as to capital gain.

In case of doubt taxing statutes are to be construed most strongly against the Government and in favor of the citizen. *United States v. Wigglesworth,* 2 Story 368, 374; *United States v. Isham,* 17 Wall 496, 504; *Gould v. Gould,* 245 U. S. 151, 153; *United States v. Merriam,* 263 U. S. 179.

The rule applies as this is a deduction and not an exemption provision.

There seems to be a serious doubt as to the proper construction of Section 214 (a) (8) of the Revenue Act of 1918. The Commissioner of Internal Revenue, the Advisory Tax Board, the Rules and Regulations Section of the Bureau of Internal Revenue, and the Legal Department of the office of the Commissioner of Internal Revenue had no doubt whatsoever regarding the proper construction. Their construction uniformly was to the effect that the taxpayer was entitled to the deduction on account of obsolescence of intangibles, including good will. The United States District Court for Kentucky, if it had such doubt, resolved it in favor of the taxpayer in so far as intangibles, other than good will, was concerned. The conflicting opinions of the Circuit Courts of Appeals for the Second and Eighth Circuits certainly gave rise to a serious doubt as to the proper method of construction.

That doubt, we respectfully submit, if it exists in the minds of this Honorable Court, should be resolved in favor of the taxpayer.

CONCLUSION.

The petitioner had intangible assets consisting of good will, trade marks, trade brands, and trade names in both his distillery and wholesale liquor businesses which were worth $1,000,000.00 and $115,500.00, respectively, on March 1, 1913. On January 31, 1918, it was apparent that the value of the intangible assets would be destroyed or lost within a period of about four years. During such period the intangible assets were in the state of becoming obsolete—their value was being exhausted by lapse of time caused by prohibiting legislation. The said intangible assets were wholly destroyed by prohibition legislation. Petitioner should be allowed as a deduction from gross income a reasonable allowance for obsolescence, (the amount not being

disputed in the lower court) or in the alternative a deduction for the loss of the cost of such intangibles.

A similar deduction should be allowed petitioner for obsolescence of physical properties over the same period. The fact that medicinal whiskey was manufactured does not destroy the deduction. Obsolescence is not obsoleteness.

Petitioner owned the "Old Whiskey" personally. It was not part of his stock in trade. In any event he is entitled to the benefit of the capital gain provision because a business in forced liquidation under restrictions as to sale, with no means of replacement, has no stock in trade but only frozen capital assets.

The decision of the Circuit Court of Appeals herein should be reversed.

Respectfully submitted,

EDWIN W. SMITH,
WILLIAM A. SEIFERT,
WILLIAM WALLACE BOOTH,
Attorneys for Petitioner.

APPENDIX.

Statutes.

Revenue Act of 1917, Act of October 3, 1917, ch. 63, Section 207 (a), 40 Stat. 300:

> Section 207. * * * "As used in this title 'invested capital' does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title, nor money or other property borrowed, and means, subject to the above limitations: * * * Provided that * * * (b) *the good will, trade-marks, trade brands,* the franchise of a corporation or partnership, or other intangible property shall be included as invested capital * * *".

Revenue Act of 1918, Act of February 24, 1919, ch. 18, 40 Stat. 1057:

> Section 214: "(a) That in computing net income there shall be allowed as deductions (4) losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in a trade or business; * * *"
>
> * * * * * * *
>
> Section 214: "(a) That in computing net income there shall be allowed as deductions: (8) a reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913."

"Part V. Invested Capital. Section 325. (a) That as used in this title—

"The term 'intangible property" means patents, copyrights, secret processes and formulae, good will, trade-marks, trade brands, franchises, and other like property; * * *

"Section 326. (a) That as used in this title the term 'invested capital' for any year means (except as provided in subdivisions (b) and (c) of this section):

* * * * * * *

"(4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917 * * *;

"(5) Intangible property bona fide paid in for stock or shares on or after March 3, 1917 * * *."

Revenue Act of 1921, Act of November 23, 1921, ch. 136, 42 Stat. 227:

Section 206: "(a) That for the purpose of this title: (6) The term 'capital assets' as used in this section means property acquired and held by the taxpayer for profit or investment for more than two years (whether or not connected with his trade or business), but does not include property held for personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year."

Section 206: "(b) In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a tax determined as fol-

lows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner provided in sections 210 and 211, and the total tax shall be this amount plus 12½ per centum of the capital net gain: but if the taxpayer elects to be taxed under this section the total tax shall in no such case be less than 12½ per centum of the total net income. The total tax thus determined shall be computed, collected and paid in the same manner, at the same time and subject to the same provisions of the law, including penalties, as other taxes under this title."

* * * * * * *

Section 214: "(a) That in computing net income there shall be allowed as deductions: (8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913."

Section 325 (a) and 326 (a) (4) (5) are the same as corresponding sections of the Revenue Act of 1918, supra.

with any provision of the National Prohibition Act or of this Act; but if any act is a violation of any of such laws and also of the National Prohibition Act or of this Act, a conviction for such act or offense under one shall be a bar to prosecution there for under the other. All taxes and tax penalties provided for in section 35 of Title II of the National Prohibition Act shall be assessed and collected in the same manner and by the same procedure as other taxes on the manufacture of or traffic in liquor.

If distilled spirits upon which the internal-revenue tax has not been paid are lost by theft, accidental fire, or other casualty while in possession of a common carrier subject to the Transportation Act of 1920 or the Merchant Marine Act, 1920, or if lost by theft from a distillery or other bonded warehouse, and it shall be made to appear to the commissioner that such losses did not occur as the result of negligence, connivance, collusion, or fraud on the part of the owner or person legally accountable for such distilled spirits, no tax shall be assessed or collected upon the distilled spirits so lost, nor shall any tax penalty be imposed or collected by reason of such loss, but the exemption from the tax and penalty shall only be allowed to the extent that the claimant is not indemnified against or recompensed for such loss. This provision shall apply to any claim for taxes or tax penalties that may have accrued since the passage of the National Prohibition Act or that may accrue hereafter. Nothing in this section shall be construed as in any manner limiting or restricting the provisions of Title III of the National Prohibition Act."

APPENDIX.

Willis Campbell Act of November 23, 1921, Chapter 134, Section 2, 42 Stat. 222.

"* * * No spirituous liquor shall be imported into the United States, nor shall any permit be granted authorizing the manufacture of any spirituous liquor, save alcohol, until the amount of such liquor now in distilleries or other bonded warehouses shall have been reduced to a quantity that in the opinion of the commissioner will, with liquor that may thereafter be manufactured and imported, be sufficient to supply the current need thereafter for all non-beverage uses: PROVIDED, That no vinous liquor shall be imported into the United States unless it is made to appear to the commissioner that vinous liquor for such non-beverage use produced in the United States is not sufficient to meet such non-beverage needs: PROVIDED FURTHER, That this provision against importation shall not apply to shipments en route to the United States at the time of the passage of this Act: And PROVIDED FURTHER, That the commissioner may authorize the return to the United States under such regulations and conditions as he may prescribe any distilled spirits of American production exported free of tax and reimported in original packages in which exported and consigned for redeposit in the distillery bonded warehouse from which originally removed."

Treasury Department Rulings.

Treasury Department Bureau of Internal Revenue

BULLETIN "F"
INCOME TAX.

DEPRECIATION AND OBSOLESCENCE.

REVENUE ACT OF 1918.

This bulletin contains information from which taxpayers and their counsel may obtain the best available indication of the trend and tendency of official opinion in the administration of the income and profits tax provisions of the Revenue Act of 1918, with respect to depreciation and obsolescence. It does not have the force or effect of a Treasury Decision and does not commit the Department to any interpretation of law which has not been formally approved and promulgated by the Secretary of the Treasury.

Taxpayers and officers of the Bureau of Internal Revenue are cautioned against reaching a conclusion in any case merely on the basis of similarity to conditions stated herein and should base their judgment on the application of all pertinent provisions of the law, regulations, and other Treasury Decisions to all of the facts in each case.

[Seal—Office of
Commissioner of
Internal Revenue]

WASHINGTON
GOVERNMENT PRINTING OFFICE
1920

INTRODUCTION.

The contents of this bulletin indicate the trend and tendency of official opinion in the Bureau of Internal Revenue in administering the portions of the Revenue Act of 1918 which provide for the deduction from gross income of reasonable allowances for exhaustion, wear and tear, and obsolescence of property used in trade or business. The subject matter includes Treasury Decisions, Opinions of the Solicitor of Internal Revenue, the Advisory Tax Board and the Committee on Appeals and Review, portions of Regulations 45 and other information of a general nature.

Since obsolescence was not recognized for income-tax purposes prior to the passage of the Revenue Act of 1918, comparatively few rulings have been made on that subject. This bulletin, however, contains several opinions rendered by the Advisory Tax Board relating to intangible assets and other property rendered obsolete by prohibition legislation.

The Bureau does not prescribe rates to be used in computing depreciation and obsolescence, as it would be impracticable to determine rates which would be equally applicable to all property of a general class or character. For this reason no table of rates is published. The rate applicable and the adjustment of any case must depend upon the actual conditions existing in that particular case.

[Page 4]

[Page 9]

DEPRECIATION OF INTANGIBLE PROPERTY. — Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses and franchises. Intangibles, the use of

which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner. The words "capital outlay" used in this paragraph mean cash, other property, or corporate stock given in exchange for the intangibles.

[Page 14]

OBSOLESCENCE OF INTANGIBLES. — Obsolescence is not ordinarily applicable in the case of intangibles but will be allowed in exceptional cases, as in the case of the discontinuance of a going business because of the exhaustion of its source of supply, where the cost of the good will, or its value as of March 1, 1913, if acquired prior to that date, can be definitely shown and the period of its obsolescence determined with reasonable accuracy.

To sustain a claim for deduction for obsolescence of good will, it must be shown that the good will will be of no value at the close of an approximately definite period, and that the taxpayer will be forced to discontinue the business and be unable to continue in another similar business.

An allowance for obsolescence of good will will be made only in connection with such good will as is assignable, as distinguished from good will attaching to individuals owning or conducting a business or to the premises at which it is or was conducted; and no allowance for obsolescence will be granted in any case where, in connection with the operation of the business, the

good will will be valuable in another business after the termination of the business in which the taxpayer is engaged.

* * * * * * * *

BOTTLE MANUFACTURING PLANTS. — Property consisting of a plant, including equipment, for the manufacture of beer bottles, which because of prohibition legislation has lost its usefulness and can not be sold has, to the extent the property or plant was constructed for the manufacture of beer bottles and is not suited or adapted for any other [p. 15] purposes without reconstruction, become obsolete, and the taxpayer to that extent is entitled to a deduction for obsolescence. That part of the shrinkage in value of the plant, if any, which is not thus due to obsolescence may not be claimed as a deduction for loss until the property is sold or becomes worthless and the loss is definitely ascertained.

PROPERTY OF BREWERS AND DISTILLERS.—The same principle stated in the case of bottle manufacturing plants is applicable in the case of other property or equipment of distillers, brewers, and liquor dealers which has been impaired in value through prohibition legislation. The loss in value may be established by evidence other than the actual sale of the obsolete property.

INTANGIBLE ASSETS OF BREWERS, DISTILLERS, AND DEALERS IN LIQUOR.—In Advisory Tax Board Memorandum 44 (Cumulative Bulletin, December, 1919, p. 133) it was held that distillers and dealers in liquor are entitled to make a deduction (based upon actual cost or fair market value as at March 1, 1913) from gross income, on account of depreciation or obsolescence of their intangibles, such as good will, trademarks, trade brands, etc., such deduction being limited to assignable assets, the value of which has been destroyed by prohibition legislation, and that in arriving at the taxable

income for the first taxable year ending on or after January 31, 1918, the obsolescence fully accrued on that date is to be allowed as a deduction in computing the income subject to taxation under the Revenue Act of 1918, plus a further deduction of such proportion of the remaining value of the intangible assets as the interval between January 31, 1918, and the end of the taxable year bears to the total interval between January 31, 1918, and January 16, 1920 (unless at an earlier date the taxpayer discontinues his business in which case such earlier date shall mark the close of the period), and that for any taxable year following the taxable year just referred to a deduction in respect of the value of such intangible assets on January 31, 1918, based upon a ratable distribution, will be permissible. This paragraph applies also to brewers.

23-19-545.
T. D. 2929.

Section 214 (a) 8, Article 163: Depreciation of intangible property.

MODIFICATION OF ARTICLE 163, REGULATIONS NO. 45—DEPRECIATION OF INTANGIBLE PROPERTY.

Article 163. Regulations 45, is modified to read as follows by eliminating therefrom the last sentence reading, "There can be no such allowance in respect of good will, trade names, trade-marks, trade brands, secret formulae, or processes":

Art. 163. *Depreciation of intangible property.*—Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses and franchises. Intangibles, the use of which in the business or trade is not so limited,

will not usually be a proper subject of such allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the commissioner.

15-19-445.
T. B. R. 44.

Section 214 (a) 8, Article 163: Depreciation of intangible property.

Obsolescence upon intangible assets such as good will, trade-marks, or trade brands may be deducted, within certain definite limitations in computing taxable net income.

In an office letter to A, it is held that distillers and dealers in liquors are entitled in computing taxable net income to deduct a reasonable allowance for obsolescence of good will, trade-marks, or trade brands, the value of which has been impaired or destroyed by prohibition legislation, such deduction to be computed upon the basis of a period beginning on November 21, 1918, the date upon which the Agricultural appropriation act providing for war-time prohibition was enacted, and July 1, 1919, the date upon which war-time prohibition was to become effective. It was further held (a) that to sustain a claim for a deduction for obsolescence in respect of good will, trade-marks, or trade brands, the taxpayer must show that the value of the property in question has been destroyed or will be destroyed by prohibition legislation, and that the taxpayer is not continuing in any similar trade or busi-

ness; (b) that an allowance will be made only in respect of such assets as are assignable as distinguished from those attaching to individuals owning or conducting the business, or to the premises at which it is being or has been conducted; and (c) that no allowance for obsolescence will be made in any case where in connection with the operation of his previous business, the taxpayer has developed a good will, trademark, or trade brand that will be valuable in continuing a lawful business after prohibition becomes effective.

A has appealed to the Commissioner claiming that the above decision errs in limiting the period over which the obsolescence may be spread from November 21, 1918, to June 30, 1919. He takes the position "That the depletion by obsolescence is the result of the Federal prohibition process, which has been in the course of development * * *;" that although "The trade made substantial apparent profits in 1918" this resulted merely from the liquidating of inventories, and "trade was garnering apparent profits which in reality were only the salvaging of capital * * *;" and urges that if a fixed obsolescence period is to be stated, "The Department conclude that December 18, 1917, the date of the action of the House of Representatives which constituted the final submission of national prohibition to the States, be taken as the point of commencement of the obsolescence."

The question raised, therefore, is whether the period during which the obsolescence may be spread should be limited to that beginning on November 21, 1918, or should be taken as from December 18, 1917, the date upon which Congress submitted the prohibition amendment to the States.

Before considering this question directly, it seems desirable to examine the grounds upon which obsoles-

cence of intangibles, such as good will, trade-marks, trade brands, etc., may be allowed. In the accounting required for tax purposes intangibles, such as good will, trade-marks, and the like are distinguished from tangible property in that in the ordinary case a taxpayer is not required or permitted to make current deductions for depreciation, including in this term ordinary obsolescence. This distinction rests upon the ground that in the ordinary case depreciation of intangibles is too indefinite and uncertain to be reduced to terms of money. In specific instances, however, intangibles may be brought within the rule applicable to tangible property, but only by the force of unusual and controlling circumstances. Article 163 of Regulations 45, for instance, states that "Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance." It is true that this same article states that no such allowance may be made in the case of intangibles of the class now under consideration, and while in general this negative decision is sound, the controlling rule is the one quoted above, and when an item of intangible property falls within that rule it must be dealt with accordingly. The major rule laid down in article 163 is a reasonable extension of the provision of article 143 covering loss of useful value. This article provides "When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation allowance) and its salvage value remaining * * *."

The question next arises whether an intangible acquired at a date when its useful life is indefinite may become the subject of a depreciation allowance at some subsequent date at which time the duration of its useful life becomes definitely known. If so, the loss which might be claimed at the end of the life may be spread over the term of the remaining useful life. To hold that no such spread is allowed it is necessary to construe the first sentence of article 163 as meaning that only those intangibles the useful life of which is known at the time of acquisition to be definitely limited in duration may be the subject of depreciation allowance. This seems to be a strained construction, and in the light of article 143 is unnecessarily harsh. The reasonable conclusion seems to be, therefore, that when it is demonstrated that the useful life of an intangible is definitely limited, such intangible then becomes a proper subject of depreciation allowance.

Applying these considerations to the intangibles belonging to distillers and dealers in liquors it is found that such intangibles are subject to depreciation (or obsolescence) during the period in which it is known that their useful life is definitely limited in duration. The determination of this period is, however, by no means easy. Looking backward it can now be seen that prohibition has during recent years had a rapid growth in this country, particularly in the South and in the West. Before the constitutional amendment was adopted some 33 States had prohibition legislation and local option was similarly effective in substantial parts of many of the other States. As early as March, 1913, the Webb-Kenyon Act gave strong indication of a growing sentiment, and this sentiment has since been registered in many other political and judicial expressions.

However clear the general implication of these

facts may have been, nothing throughout this course of events was sufficiently explicit and final to fix a period at the end of which the property now under consideration would become valueless. Among these indefinite or incomplete events the submission by Congress of the eighteenth amendment on December 18, 1917, stands out as the most far-reaching and important in the entire chain. The fact that this legislation was adopted in both Houses of Congress by large majorities gave at least some indication of the probable reception of the proposed amendment by the States, and it may, therefore, be granted that at the date of submission there was substantial reason to believe that the amendment would be adopted by the States.

There was, however, no certainty upon this point, and the leaders on both sides of the controversy showed plainly by their actions at the time that neither believed that the issue was settled. Were it not for the facts surrounding the submission of the constitutional amendment, a satisfactory date would be fixed by the adoption of the war-time prohibition act on November 21, 1918. Standing alone this date could be accepted as marking the beginning of the period during which the trade-marks, trade brands, and good will of distillers and dealers in liquors would be completely exhausted. The prohibition amendment, while not finally adopted until after the enactment of war-time prohibition had, however, made such progress that before that date its adoption became a foregone conclusion. The attitude of many States was known, and the formal act of ratification merely awaited the assembling of the legislatures. The trend of sentiment was early shown by the action of several States upon which the distillers and dealers in liquors were counting for success, and which were classed as doubtful by the prohibition forces. Thus in January, 1918, Massachusetts, Mary-

land, and Kentucky, the first two of which were considered very doubtful by the prohibitionists, voted in favor of the prohibition amendment by a decisive vote. Louisiana, another doubtful State, deadlocked in January upon the amendment, and later in the year ratified. It seems certain that an unprejudiced observer would, in view of the history of the movement and the decisive action taken by these doubtful States in January, have concluded that prohibition was a certain event, which, under the terms of the amendment, would become effective within a year from its final adoption. The conclusion is, therefore, reached that it is reasonable to allow distillers and dealers in liquors to make a deduction in computing net income under the provisions of the Revenue Act of 1918, for any taxable year ending on or after January 31, 1918, and that the end of the period be fixed at the date upon which a taxpayer engaged as distiller or dealer in liquors discontinues such business, such date being in no case later than January 16, 1920, the date upon which prohibition by constitutional amendment becomes effective.

A further question remains for consideration. Upon what basis should the deduction for obsolescence be apportioned between the taxable years ending after January 31, 1918? The statute, sections 214 (a) (8) and 234 (a) (7), provides for a "reasonable" allowance. This places upon the department the burden of laying down rules and regulations defining, so far as may be done, what is "reasonable." In the great majority of cases depreciation is fairly measured by the effluxion of time. This is the ordinary rule, a departure from which should be allowed only when the deduction provided thereunder does not meet the statutory requirement of reasonableness. The use in the statute of the word "reasonable" clearly implied that no rigid rule applicable to all cases can be laid down.

Observation of individual cases amply proves that this is true, and therefore when the ordinary rule does not produce a reasonable result, the statute requires that another and a reasonable method be adopted in a particular case or class of cases. The situation presented by the distillers and dealers in liquors is highly exceptional. The total amount in respect of which they are entitled to claim a deduction is the cost of their good will, trade-marks, trade brands, or the value thereof, on March 1, 1913, if acquired prior thereto, excluding, of course any intangibles acquired since that date, the expenditures for which were deductible in computing income for tax purposes. But as already indicated, the legislative situation had by January 31, 1918, reached a decisive point which completed the first stage in the obsolescence of these assets. On that date a computable part thereof had become obsolete. The value of such assets rests upon the probable future income that will accrue to the owner thereof. Estimates of the probable amount of this income may vary, but there is no other known method by which the value can be computed. In view of the status of prohibition legislation on January 31, 1918, it is certain that upon that date the value of the good will, trade-marks, trade brands, etc., of distillers and dealers in liquors was reduced to the then present value of the income to be derived therefrom between that date and approximately January, 1920. Whatever this value might be in a given case, it would be different from, and probably much less than, the value on March 1, 1913. Had prohibition been immediately effective, instead of becoming operative at a future date, these taxpayers would have been entitled to deduct from gross income of any taxable period ending on or after January 31, 1918, the entire amount of such intangibles.

Depreciation of intangibles now in question when

computed upon the basis of the time rule does not meet the requirements of the statute, and therefore another rule must be found. For some purposes apportionment based upon the relative profits of two or more taxable periods provides a proper method, but this rule is obviously inapplicable to the cases now under consideration. The rule of apportionment which most closely approximates the actual facts, and is therefore the most reasonable, is that under which the value of the intangibles on January 31, 1918, is spread on the time basis between that date and the date upon which prohibition became effective and the balance of the allowable deduction (measured by the difference between the value on January 31, 1918, and March 1, 1913), taken in accordance with the provisions of section 205 of the act and articles 1621-1625 of Regulations 45 against the first taxable year ending on or after January 31, 1918.

It is, therefore, the opinion of the Advisory Tax Board (1) that distillers and dealers in liquors are entitled to make a deduction (based upon actual cost or fair market value as at March 1, 1913) from gross income, on account of depreciation or obsolescence of their intangibles, such as good will, trade-marks, trade brands, etc., such deduction being limited to assignable assets, the value of which has been destroyed by prohibition legislation, and (2) that in arriving at the taxable income for the first taxable year ending on or after January 31, 1918, the obsolescence fully accrued on that date is to be allowed as a deduction in computing the income subject to taxation under the revenue act of 1918, plus a further deduction of such proportion of the remaining value of the intangible assets as the interval between January 31, 1918, and the end of the taxable year bears to the total interval between January 31, 1918, and January 16, 1920 (unless at an earlier date the taxpayer discontinues his business, in

which case such earlier date shall mark the close of the period), and (3) that for any taxable year following the taxable year just referred to a deduction in respect of the value of such intangible assets on January 31, 1918, based upon a ratable distribution, will be permissible.

24-19-565.
O. D. 298.

Section 214 (a) 8, Article 163: Depreciation of intangible property.

Deductions from gross income on account of depreciation or obsolescence of intangibles, such as good will, trade-marks, and trade brands, allowed distillers and dealers in liquors, are also applicable to brewers.

30-19-640.
O. D. 344.

Section 214 (a) 8, Article 163: Depreciation of intangible property.

Depreciation of intangible property as explained in article 163 of Regulations 45 applies to all intangible property including patents and copyrights, whether acquired for cash, other property, or corporate stock. The term "capital outlay" includes corporate stock.